March 27, 2013

Small Business Tax Reform Working Group
Ways and Means Committee
United State House of Representatives
Washington, DC 20515

On behalf of the Small Business Legislative Council (SBLC), we would like to offer the following observations about the proposed "small business" draft revisions to the Internal Revenue Code (IRC).

We want to begin by complimenting the Chairman for his bold and innovative effort to begin a process that could ultimately lead to a unified business taxation system. We believe that it will be difficult to simplify the tax responsibilities of small business and do so in a fair way until we achieve some measure of unification.

We support the initiative to increase permanently and index for inflation the direct expensing allowance under IRC Section 179. We would prefer the allowance level be set initially at $500,000 and the "cap" on purchases be set at $2 million, the current temporary amounts. While the merits of the direct expensing allowance for the small business purchasers are frequently extolled, we do want to point out that there are many small businesses that make, fabricate, distribute, and sell equipment and machinery. In that regard, they might have a piece of equipment that might be within the direct expensing allowance but the purchaser's total annual purchases might exceed the relevant cap. The current workplace often consists of several distinct components integrated for efficiency. In that regard, the suggested cap of $800,000 may be too low to accommodate that reality.

We support the proposal to revise and expand the ability of small businesses to utilize cash basis tax accounting practices. Our principal concern is that the proposal will not achieve any significant measure of simplicity without one important change – the cash basis taxpayers should not be required to maintain inventories. Over the last 50 years, the push has been to force small business taxpayers to defer recognition of realized expenses through either accrual accounting or even worse, capitalization (e.g. IRC Section 263A). It has led to only more complexity. Furthermore, it is time to change the dynamic. Rather than accelerating a business's tax liability why not allow them to recognize the expenses as they are realized? (Indeed that is what the direct expensing allowance achieves for capital assets.) Ultimately, it is about tax liability timing not about reducing tax liability. Once small business taxpayers are on a system the timing issue will smoothen itself out but the small business's tax liability would better match its real world accounting and cash flow situation.

Without the inventory accounting requirement elimination, neither distributors nor retailers would be able to take advantage of the proposal. In addition, there are many other businesses that would be caught in a grey area. SBLC has a long history of working through the cash basis

accounting dilemma. We were actively involved in the discussions that led to some administrative relief in the early 2000's for some small businesses. (Revenue Procedure 2002-28 was the final product.) Those discussions confirmed that it has become increasingly difficult to draw clear lines between materials and supplies, "incidental" inventory and full inventory situations. The lesson we learned is that the brightest line – no inventory accounting – is the best line. Without it, we do not believe we will be able to tout the move to cash basis tax accounting as a simplicity victory.

We might note that the $10 million limitation is not indexed. Our experiences with the alternative minimum tax and the estate tax have made us leery of non-indexed provisions. We recognize that the $10 million is a rolling three-year average and it might make it more complicated to provide for indexing, but we urge the Committee to take a close look at the indexing concern and whether something can be done to provide flexibility.

We are not prepared to offer an opinion as to the merits of the two options for unifying the treatment of S Corporations and partnerships other than we support the unification for the reason stated before - that we need to do that first before we can make additional simplification and fairness progress. We would also note that as we move forward, while there is a temptation to use the C Corporations versus pass through entities as a short hand for the differences between big and small businesses; that is not necessary true. Size of business based on gross receipts holds true on both sides of the equation and as we move further towards unification, we may have to reconsider how we view the business size ladder.

Under one proposal, pass through entities would be responsible for withholding taxes at the entity level for distribution recipients. Under current law, most of those recipient taxpayers are responsible for paying estimated taxes. While we would never be keen about any withholding requirement, we understand that the practical net impact on a taxpayer may be modest between paying estimated taxes and withholding. The best alternative we can see is to perhaps create a safe harbor as we do now for the payment of estimated taxes (e.g. 66.67 percent, 100 percent, or 110 percent, depending on the taxpayer's situation, of tax shown on previous year's return.) In the first year, it probably would be based on previous year's estimated taxes. In subsequent years, it could be based on the previous year's withholding.

With respect to non-complex or non-real estate based partnerships, we believe most small business partnerships have allocations that are based on factors such as age and experience rather than tax motivations. For example, a small manufacturers' representatives agency might have two partners who are "fifty-fifty" partners but might have different distributions based on the fact one partner has ten years more experience. Over time, those distributions may change or even flip as one partner closes in on retirement. Therefore, we urge the Committee to consider the ramifications of any changes on those situations. Current law has a number of provisions directly related to those situations.

Finally, we support the consolidation of the "startup" costs tax treatment changes, the tax return due date simplification and the shortening of the built in gain period for conversion from C Corporation to S Corporation.

We hope these comments are useful and we look forward to working with the Committee to achieve fair and meaningful tax reform.

Sincerely

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The Small Business Legislative Council is a permanent, independent coalition of over 50 trade and professional associations that share a common commitment to the future of small business. Our members represent the interests of small businesses in such diverse economic sectors as manufacturing, retailing, distribution, professional and technical services, construction, transportation, and agriculture. Our policies are developed through a consensus among our membership. Individual associations may express their own views.